



U.S. Freight Railroads and the Capacity Problem

STB Commissioner Francis P. Mulvey

ODU Maritime Speaker Series at Nauticus

Norfolk Virginia –April 4, 2005



Background

RRs Expanded Rapidly Especially After Civil War

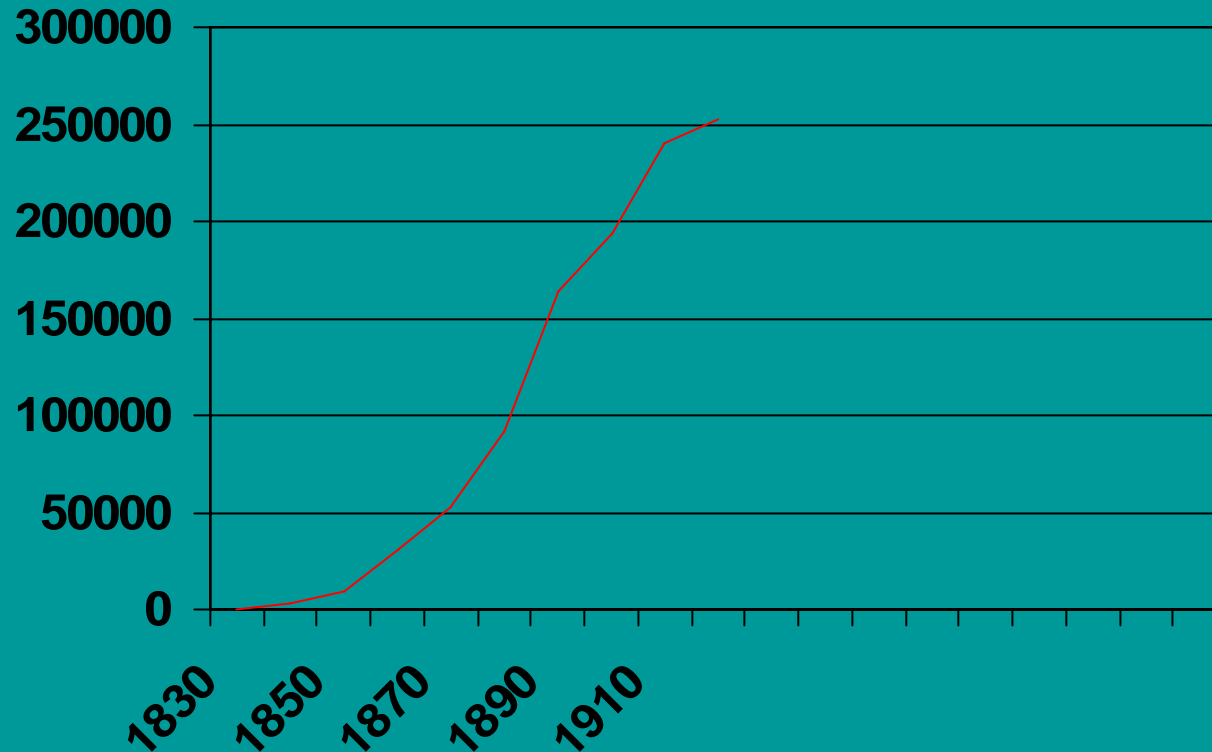
Much Overbuilding Encouraged by Land Grants,
Speculation, etc

Railroads, as an industry and individually, faced
financial crises periodically

Combination of periodic crises and desire to protect farm
interests led to IC Act of 1887

Railroad Mileage Reached Peak at Outbreak of WWI

US Railroad Mileage 1830-1920





Background

Development of Highway Modes after 1920
Exacerbated RRs' Chronic Excess Capacity

Great Depression made matters worse

Railroad Traffic had a Resurgence during WWII

Traffic Decline Resumed at War's End and Passenger
Traffic Losses Accelerated with Growth of Air Travel



U.S. Railroads Prior to Staggers Act

Much of the Rail Network, Especially in the East, was Bankrupt

Railroad Industry was Uncompetitive

Excess Capacity Abounded

Regulatory Lag and the Regulatory Mentality

The Staggers Act of 1980

Impact of Staggers Act

- Freed Railroads from Excessive Regulation
- Competitive Traffic Exempt from Regulation
- Railroads Free to Enter into Contract Rates
- Eased Abandonment of Light Density Lines



Impact of Staggers Act

Railroads Rationalized their Networks through Mergers

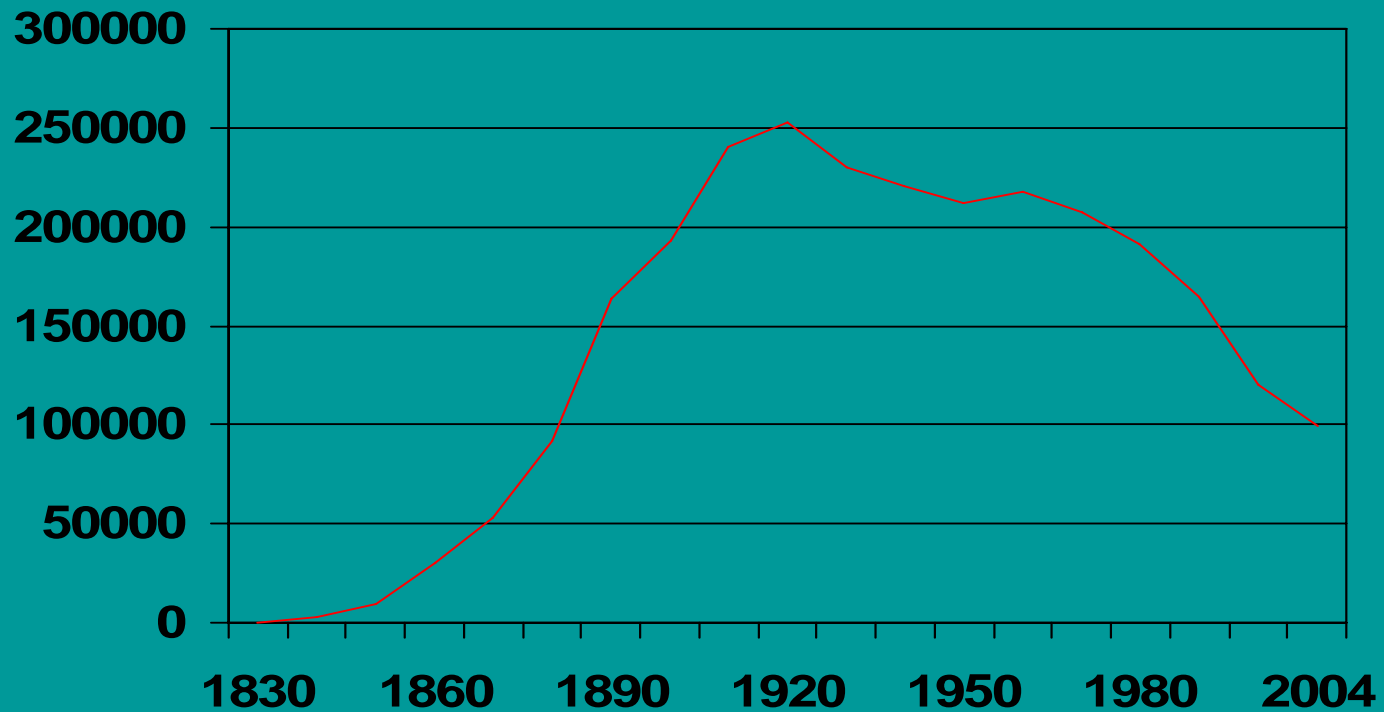
Railroads Reversed Market Share Decline

Railroad Industry Profitability Improved

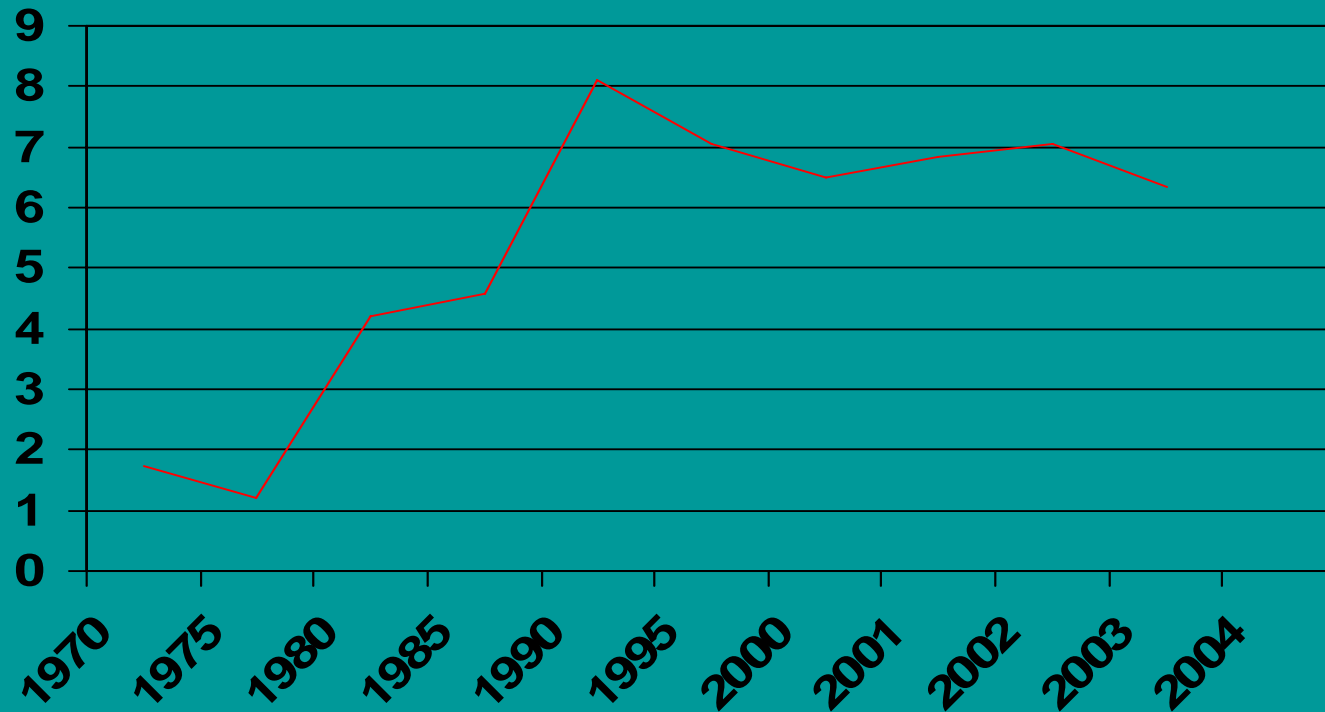
Class I Network Mileage Shrunk



Growth of Railroad Mileage



Railroad ROI 1970-2003





The Railroads' Dilemma

Improved Earnings Still not Revenue Adequate
Railroads “Punished” by Wall Street for Making
Capital Investments

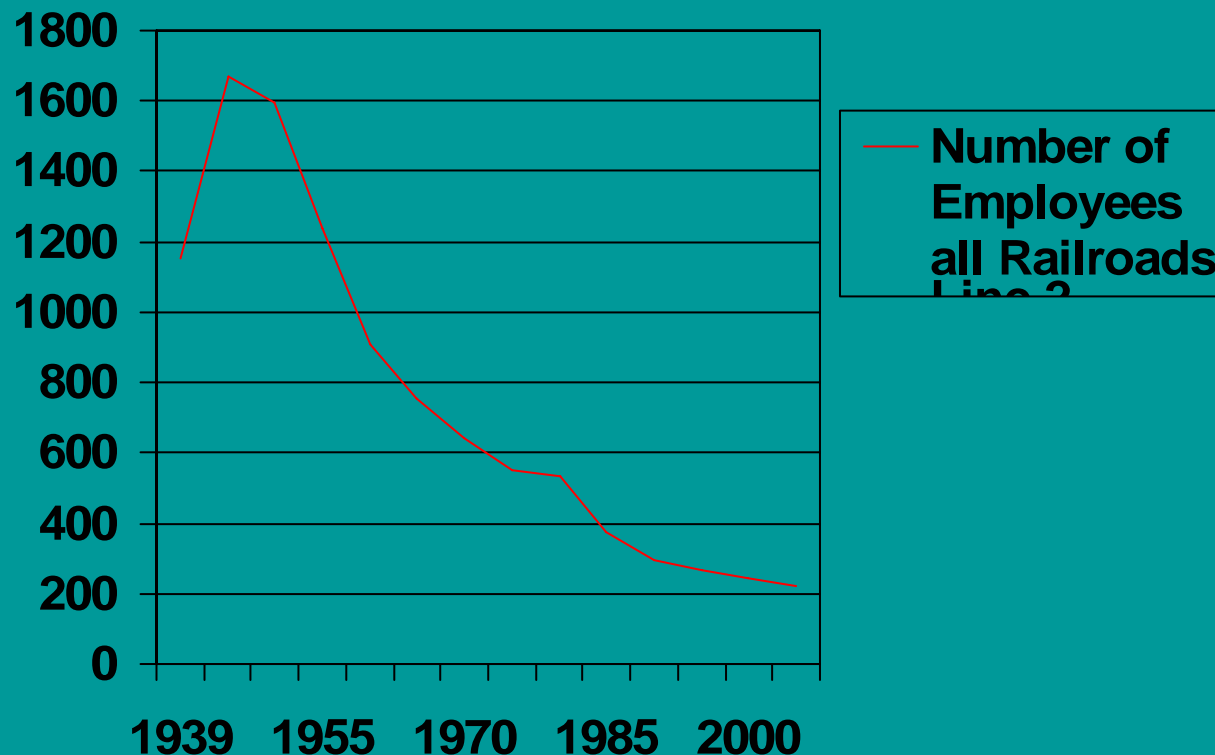
Railroads Often Found that Infrastructure Investments
Failed to Generate Sufficient Income

Long term Strategy to Reduce Size of Workforce

Added Rail Infrastructure is Long-Lived While Demand
Increases can be Short-Lived

Railroad Employment 1939-2003

(in thousands)



The Developing Rail Capacity Crisis

Shrinking Workforce and Infrastructure Partly
Offset by Productivity Improvements

But Continuous Increase in Traffic Begins to
Absorb “Excess Capacity”

Network becomes More Vulnerable to
Stochastic Events

A Perfect Storm or the Rail Version of Global
Warming



Capacity Problems-2003-2004

Expanding Economy Led to Surge in Imports

Large Grain Harvests in 2003 and 2004

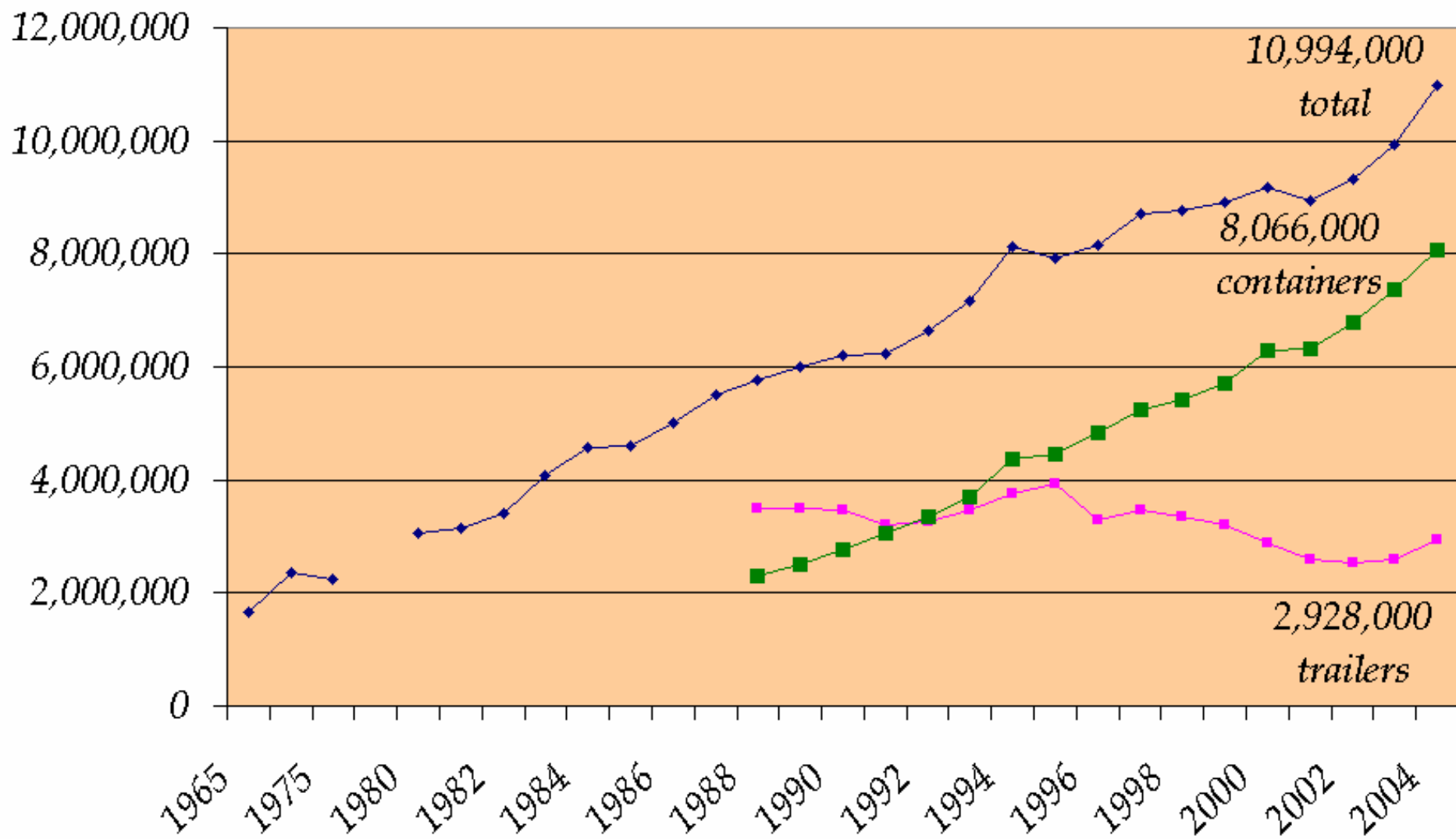
Growth in Export Coal Market

Crew Shortages due to Wave of Retirements

Equipment Shortages due to Reduced Purchases



Intermodal Shipments beginning 1965



Capacity Problem-2003-2004

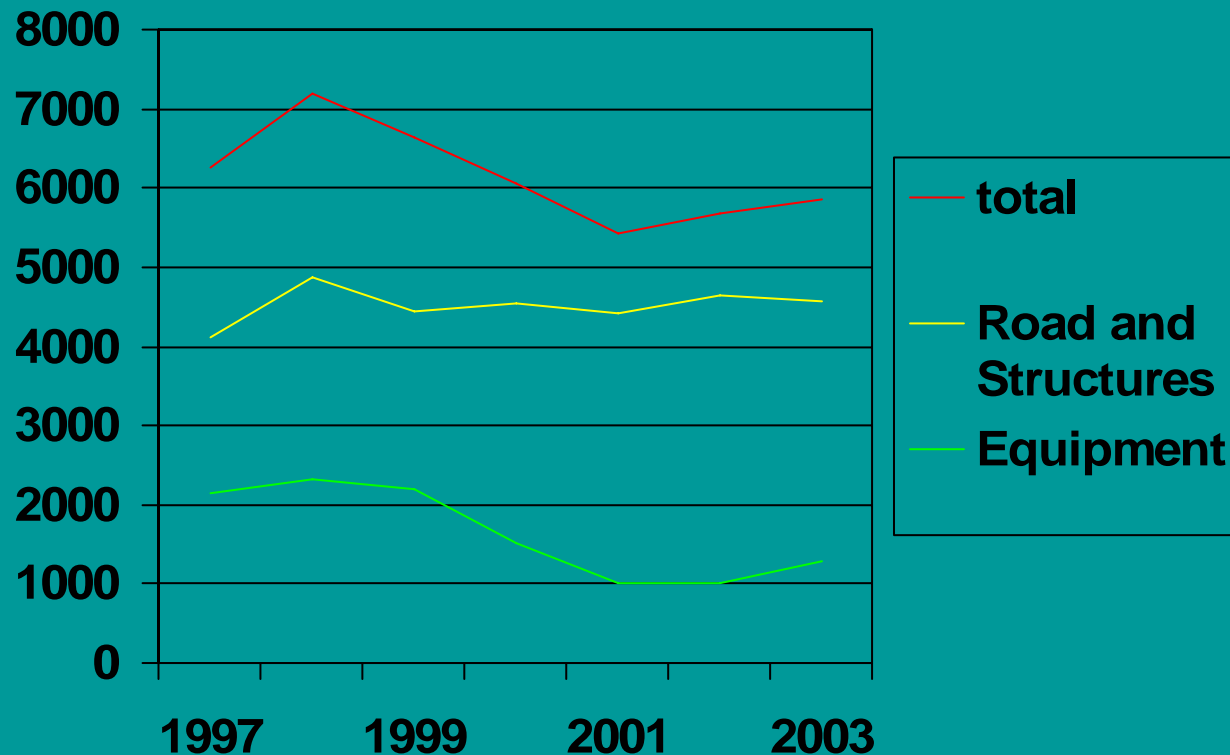
Cutbacks in Capital Spending Programs

Tight Capacity in Trucking Industry due to Driver Shortages, Higher Fuel Costs, HOS Rules, etc.

A Perfect Storm? .



Class I Capital Expenditures (in billions of current \$)



Carrier Responses to Recent Capacity Problem

More Cars and Locomotives Bought and Leased

Accelerated Hiring and Training of Train Crews

Some Infrastructure Expansion Efforts

Price Rationing of Available Capacity

Railroads Choosing who they will Serve and the
Common Carrier Obligation





Long-Term Rail Capacity Constraint Factors

Demand for Freight Rail Transport Projected
to Grow by 60%-70% over Next Two Decades

Railroads' Inability to Earn Cost of Capital

Pressure from Wall Street to Reduce Capital Costs
and Improve ROI

Long-Term Contracts Limit Railroad
Pricing Flexibility

Railroads tend to Bid Long Term Contract
Rates Down to Long Run marginal Costs



Railroad Cost of Capital and ROI

Sources: Annual R-1 Reports and AAR

	Cost Of Capital	BNSF	CSXT	NS	UP	KCS	SOO	GT	IC
1996	11.9%	8.6%	8.9%	13.0%	9.3%	7.2%	23.5%	0.0%	15.2%
1997	11.8%	8.4%	9.8%	13.1%	5.2%	3.6%	12.3%	5.2%	15.8%
1998	10.7%	9.7%	8.1%	10.5%	2.9%	9.1%	4.9%	3.0%	13.6%
1999	10.8%	9.5%	3.8%	5.2%	6.8%	6.4%	2.5%	25.4%	10.0%
2000	11.0%	8.8%	3.6%	5.5%	6.9%	6.3%	5.6%	5.9%	5.9%
2001	10.2%	7.1%	4.6%	8.3%	7.6%	7.0%	5.9%	4.9%	4.9%
2002	9.8%	6.4%	5.2%	9.1%	8.6%	6.5%	5.7%	3.1%	3.1%
2003	9.4%	6.2%	4.0%	9.1%	7.3%	3.7%	.01%	4.5%	4.5%

What is The Role of the Public Sector?

Railroads Support Limited Role—Public/Private Partnerships (Alameda Corridor, CREATE)

Railroad Trust Fund Concept

Investment Tax Credits

- Short Lines and the 286K lb. Car Problem
- Class I Access and Limited Fiscal Capacity
- RIM and RIFF





Railroad Regulation and Capacity

STB's Role has Centered on Rate Reasonableness
for Regulated Traffic

Most Commodities are Exempt from
Regulation and/or Modally Competitive

Interstate Commerce Laws and Doctrine
Address Reasonableness of Rates and Service

Shippers want "Fairness"

What Can and Should the Board Do?



The Railroads and the Surface Transportation Board

Created by ICC Termination Act of 1995

Born out of the Deregulation Movement

Residual Economic Regulation of the Railroads

Far Smaller Staff and Scope of Authority

STB Mission

- Exclusive authority to approve of rail mergers
- Review rail rates and practices to ensure they are reasonable and not discriminatory
- Approval, including environmental review, of
 - (i) construction of any new rail line or
 - (ii) abandonment of existing lines
- Motor carrier collective ratemaking activities
- Rates for non-contiguous domestic water trade
- Rates for pipelines not carrying energy products





STB Responsibilities over Rates and Service

Oversee and Monitor Railroad Practices Nationally

Enforce the Railroads' Common Carrier Obligation

Ensure that Rates Charged Captive Shippers are
Reasonable

Assist Railroads in Earning Adequate Revenues

Calculate the Railroads' Cost of Capital



Recent Changes in STB Procedures

- Greater openness, more public meetings
- Increased reliance on mediation and technical conferences
- Expedited discovery procedures
- Greater shipper and carrier outreach



STB's Service Initiatives in 2004

- Board carefully monitored rail trends and performance metrics
- Urged open communication between railroads and shippers
 - San Francisco, Atlanta, Kansas City and Houston Service fora
 - Worked to resolve many smaller service complaints
- Asked railroads to submit their fall peak plans
- Worked with railroads and shippers on service issues



STB – 2005 Priorities

- Progress on small rate cases
- Improved customer service from carriers
- Examination of capacity constraints
- Amtrak Directed Service Mandate

Rail Consumer Assistance Program

- Facilitates informal solutions to disputes with RR's
- Brings issues to RR's attention rapidly
- Solves Problems without Litigation
- Promotes Rail Service Improvements



Is It Time to Review Rail Regulatory Policy?

- Focus on 25th Anniversary of Staggers Act and 10th Anniversary of the creation of the STB
- Proposed TRB study of railroads and regulation in the 21st Century



Thank You, Any Questions?

